WRITTEN TESTIMONY OF DON GRAVES, JR.

BEFORE A HEARING OF

THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

OF THE

U.S. HOUSE OF REPRESENTATIVES

ON DIVERSITY IN THE FINANCIAL SERVICES SECTOR

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of the
Committee on Financial Services
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Mr. Chairman, Congressman Miller and other members of the Committee. I am Don Graves, a partner with the law firm of Graves & Horton, LLC and Chief Executive Officer of Progress Through Business, a non-profit corporation with centers across the country, focused on sustaining and enhancing underserved communities through initiatives, research, networking and strategic business partnerships to empower people, and improve conditions within those communities. Progress addresses the needs of low and moderate-income individuals and communities through a variety of business-based approaches. We help in the development and growth of companies located in distressed and underserved urban and rural communities, as well as helping residents of those communities to become entrepreneurs. We assist employees and corporations by supporting new practices and systems that can improve the financial stability of the employees. And we address environmental concerns by working with partners who believe that economic development and sustainability go hand in hand. In essence, we take an integrated approach to addressing the needs of companies and low- and moderate-income people.

I commend the Committee for considering diversity in the financial services sector, and in so doing dealing with the issues of diversity within the financial services workforce itself, particularly in the upper echelons of management, and the link between workforce diversity and access to credit and capital in minority communities.

In focusing on private sector-led efforts, it is my hope that the Committee will glean useful and innovative approaches for those within the industry and those of us who work with industry. There are a number of examples of corporations that have developed strategies that have been successful in increasing diversity, whether within the company or in their clientele base. In many instances, it is not just a single company implementing new approaches that is most successful, but group of companies, companies from a geographic area, or an entire industry.

Workforce Diversity and Senior Executive Engagement

One of the things that I learned early on in working with Chief Executive Officers of the nation’s largest corporations was that the ability of Chief Executives and other senior-level executives to focus on any issue, project or program is limited. Where just 20 years ago a CEO’s tenure averaged over 8 years, the tenure of a CEO today is around 4 years. A CEO’s time, as you might imagine, is constrained to the point that their activities must revolve around increasing shareholder value, with a laser-like focus on the bottom line. As Booz Allen Hamilton posited in their report on CEO turnover, the most successful CEOs are ones that are inclusive, engaged and involved in the corporation. Senior executives no longer believe they have the luxury of spending large amounts of time on the boards of multiple social, civic or issue-oriented organizations if serving leads to a lack of engagement in the corporation.

I don't raise this as a means of excusing corporations, their CEOs and senior executives from doing there best to promote diversity, but rather as a means of suggesting that the best way to promote diversity within the senior ranks of corporations, be they within the financial services sector or otherwise, is to prove the value proposition of diversity itself. It is incumbent upon those of us who believe that diversity makes sense for business, for the economy and for the country as a whole to help the CEOs and senior executives, their boards and their shareholders to understand that by increasing diversity within the company they will also improve the company's long-term financial position. Former Federal Reserve Chairman Alan Greenspan perhaps said it best, "By removing the non-economic distortions that arise as a result of [past] discrimination, we can generate higher returns to human capital and other productive resources."

I have no illusions about the difficulty inherent in such long-range strategies for today's chief executives and the companies they lead. A CEO is the steward of the corporation's invested capital and other resources, and is expected to produce long-term growth and consistent returns to shareholders. Today's CEO, however, is increasingly judged on short-term returns and stock price movements. Business Roundtable President John Castellani has addressed the issue this way: "The fundamental reality that CEOs face today is that they are long-term managers who must depend on short-term investors for much of their capital and financial strength . . . That creates the powerful temptation for companies to play to short-term investors with short-term fixes to a company's results. But a growing number of CEOs are putting up more resistance and emphasizing their companies' long-term strengths, including non-financial strengths. They are just as committed to earnings growth. They just have a more grounded idea of how to achieve and sustain that growth over time."

Pipeline of talent for major financial institutions

As has been stated by people within the industry, and discussed in the GAO report on this topic, part of the problem of diversity is an apparent lack of minorities who are prepared to step into higher level positions with the corporation. While I am not in a position to agree or disagree with that statement, it is clear to me that the only way to solve the problem is to ensure that there are no blockages that exist within this talent pipeline. This leads me to an earlier point about CEO and board level engagement. There is anecdotal evidence suggesting that some diversity programs, led by well-intentioned CEOs have failed because of a lack of buy-in by mid-level managers who operationalize the programs. It is clear to me that these managers, and others that balk at diversity-focused efforts, have not been given the correct pitch by senior executives as to the need for diversity and don't understand the economic imperative for the corporation.

As has been stated by academics, economists, and others on this panel, and much like with a diverse supplier network, engaging in a diverse workforce protects a company's ability to deliver. Developing a diverse workforce with the consonant diverse set of experiences, backgrounds, talents and market knowledge can help safeguard the corporation from sudden market shifts. This same workforce depth can also help a corporation tap growth opportunities in previously untapped markets. Further, diversity within the workforce can also create an affinity with those same emerging markets. Employing minorities improves employment opportunities in minority communities, increasing their purchasing power and, potentially, creates an affinity for a company's brands or products within these fast-growing markets.

In thinking about the ways corporations perceive and act on issues of diversity, it is helpful to understand the process by which the companies come to grips with the issue. Simon Zadek, a senior fellow at Harvard's Kennedy School of Government and CEO of the London-based AccountAbility, developed a "Civil-Learning Tool" that melds the maturity of an issue in the broader society with organizational learning curves. Zadek uses a scale – developed by pharmaceutical company, Novo Nordisk – that identifies stages of issue development. Businesses typically go through these stages of learning in response to issues, according to Zadek's model. Corporations typically move from a defensive and compliance based mindset where they adopt a policy-based compliance approach as a cost of doing business, to a managerial stage where the issue is embedded in their core management processes as a means of mitigating the erosion of economic value in the medium term, and then finally to a strategic stage where the issue is integrated into the corporation's core business practice as a means of enhancing economic value in the long term and to gain first-mover advantage by aligning strategy and process innovations with the issue. It is the large gap between the more defensive, compliance based mindset and the more strategic approach to diversity that is at the core of industry's ability to change. Rather than spending additional time and energy on new regulatory schemes and compliance structure, we should focus on eliminating the structural problems that I just mentioned and some of the endemic problems for minority communities associated with accessing the credit and capital markets.

Existing Solutions

This hearing was to focus on private sector efforts to monitor and increase diversity in the financial services sector. In addition to those solutions being offered by members of the panels today, I believe that as a means of sharing learning and best practices we must look to a number of existing efforts by the business community that attempt to increase and monitor diversity.

The Greater Cleveland Partnership

The Greater Cleveland Partnership and one of its programs, the Cleveland Commission on Economic Inclusion, were created as an outgrowth of three business-oriented organizations in that city, the Greater Cleveland Roundtable, Cleveland Tomorrow and the Greater Cleveland Growth Association. With more than 17,000 members, the Greater Cleveland Partnership is the largest private-sector economic development organization in Ohio and one of the largest regional chambers of commerce in the nation. The organization serves as a catalyst to increase economic vitality in Greater Cleveland and the region. The Commission was created by the Partnership to significantly improve the level of inclusion – the meaningful involvement of minority businesses and individuals – in the economic engine that drives Greater Cleveland.

The Partnership and, more importantly, its leaders were convinced that a key to long-term economic growth and stability in the region was the ability of hometown corporations to bridge the gap between local minority talent and employment opportunities. The Commission was created to serve as the vehicle that could help build that bridge. What began with 28 large corporations and governmental entities in 2000 has grown to more than 100 large corporate and government members today. The program strives to be a civic model for the development and implementation of diversity and inclusion strategies that advance productivity, innovation, and economic growth. The program does so in four distinct areas:

- <u>Board Composition and Engagement</u>: The Partnership embraces board diversity as a calculated strategy to enhance organizational creativity, promote competitiveness throughout its markets, and ensure responsible and responsive corporate governance.

- <u>Operational Objectives</u>: The Partnership and its members endeavor to develop a workforce that reflects the diversity of the region. By creating wealth and opportunities through purposeful economic inclusion efforts, the Partnership believe that it will strengthen the local tax base, create a more diverse and competitive supplier base, and provide a viable incentive for greater racial and ethnic cooperation.

- <u>Member Commitment</u>: Through our Commission on Economic Inclusion, a growing network of local employers committed to a shared set of business priorities, the Partnership works to foster economic inclusion as the operating norm for businesses and organizations in Northeast Ohio.

- <u>Social Equity</u>: For the economic prosperity for the region, the Partnership supports initiatives that, among other things, promote the improvement of our urban education systems and facilitate effective preparation of our local workforce to meet the needs of current and emerging industries.

On an annual basis, the Commission selects for-profit and non-profit organizations who are "Best in Class" in Board Diversity, Senior Staff Diversity, Workforce Diversity and Supplier Diversity based on its annual survey of employer diversity. These awards provide an additional incentive for its members to strive for excellence in their organization's diversity programs.

The Commission has also developed a useful forum for its members through its Diversity Professionals Group which is composed of senior-level staff who are responsible for developing and implementing diversity management goals and initiatives within their organizations. The group holds quarterly meetings for constructive problem-solving, the sharing of best practices, and networking and educational programs about diversity and inclusion issues.

Johnson Controls
Johnson Controls, Inc. (JCI) is a Fortune 100 engineering firm that is taking a unique approach to corporate expansion. Recognizing the demographic shifts in the nation and more specifically in urban areas where JCI's Controls Division gets a large proportion of its business, the company began developing and implementing a plan whereby it could enhance its balance sheet through local economic and workforce development. By coordinating new development projects in underserved communities and working hand-in-hand with local civic leadership and non-profit organizations, JCI plans to undo urban blight while also creating new business opportunities for itself. Moreover, the company has become a first-mover by recognizing that its own workforce and that of its local business partners is largely white, male and increasingly reaching the age of

retirement and that a pipeline of talent does not exist to replace that workforce. Simply as a means of maintaining its market share, JCI is focused on recruiting and training minorities to fill jobs that are soon to be vacated by retirees. As a result, JCI has developed training programs for these employees and also customizes job and management training for adults in the community directed to meet the needs of the local community and its own workforce.

Executive Leadership Council
The Executive Leadership Council is an independent, non-profit 501(c)(6) corporation, whose mission is to provide African-American executives of Fortune 500 companies with a network and leadership forum that adds perspective and direction to the achievement of excellence in business, economic and public policies for the African-American community, their corporations and the community at large. The Council is a membership organization representing the most senior African-American corporate executives in Fortune 500 companies.

Initiatives and programs are developed by the Council and funded by The Executive Leadership Foundation, the 501 (c) (3) affiliate of The Council, with support from members and their companies. They include Senior Leadership development, Public Recognition, Mid-Level Pipeline & Talent Management, Technology & Assessment, and Higher Education. These educational and professional development programs are helping to make the case for diversity as a business imperative, and are developing the next generation of African American corporate executives, and model inclusive corporate leadership in companies working with The Council to gain insight about the complexities of the diverse workforce and barriers to inclusive leadership.

Over the years, CEOs and other corporate leaders have found that programs and initiatives supported by The Executive Leadership Foundation offer valuable career development, leadership opportunities, and dynamic public forums where CEOs and executive leaders can express their support of diversity and best diversity practices.

These types of efforts by the private sector are the right approach toward increasing diversity in the financial services sector and elsewhere. There are also countless MBA and financial services industry-led programs that have recently been developed as a means of growing the pool of trained and qualified minority candidates for senior level corporate positions. In addition to those training programs, corporations are increasingly recognizing the non-traditional career development paths that can lead to successful employment of minority candidates in senior-level positions. By looking at individuals in parts of the organization that are not normally seen as traditional paths to management, corporations often find individuals with a different skill set that is very conducive to management positions.

Access to Capital & Credit
As I mentioned at the outset, a discussion of diversity in the financial services sector must also include a discussion of diversity as it relates to the provision of financial services in underserved and diverse communities. Access to credit and capital is dependent upon the ability of an institution to understand the marketplace and to provide products that meet the needs of consumers in that community. As former Chairman Greenspan stated that "It is important for lenders to understand that failure to recognize the profitable opportunities represented by minority enterprises not only harms these firms, it harms the lending institutions and, ultimately,

robs the broader economy of growth potential. In this regard, we need to make further progress in establishing business relationships between the financial services sector and the rapidly growing number of minority- and women-owned businesses."

In October of last year, this Committee held a hearing on minority-owned banks. Much of the discussion revolved around what regulators did and did not do to support these institutions. It is also important to understand the unique set of circumstances with which they and other institutions that spend much time on underserved communities in urban and rural areas are confronted. As was stated in the testimony of Robert Cooper on behalf of the National Bankers Association at that hearing, financial institutions in these communities must offer the types of retail services that meet the particular needs of the un-banked and under-banked, including personal "high-touch" services provided at odd hours. Delving further into the problem it becomes clear that there are several inherent problems facing those who provide financial services products, including a lack of information about the community, an inability of the institution to develop creative products that can and will be used by the consumers, and financial resource and literacy constraints that prevent consumers from taking advantage of existing products.

Cultural affinity issues are also a concern. Whether or not people in the community choose to seek credit, has much to do with whether a financial institution is recognized in the community as being a good and simple source for the products that are needed by the consumer, hence the prevalence of check cashing stores and payday lenders. As a result of employment instability in these communities, access to credit becomes a much more important issue for minority borrowers either individually or for businesses, particularly given the current market constraints. Restriction of credit for non-economic reasons can be devastating to communities, but without the understanding of how to take advantage of credit opportunities, the problem is compounded.

Small Business Data

My own organization believes that economic development in underserved and diverse communities can only be accomplished through the support of scalable businesses. In the long-term, these businesses will be the true job creators and wealth builders in minority communities. The ability of the financial services industry to meet the credit and capital needs will have a major impact on the success of those businesses.

One of the problems facing those of us who look at business development issues then is the inability to get good data on businesses, and the financial services options for those businesses. Part of this problem relates to the Federal Reserve's Regulation B which prohibits financial institutions from tracking commercial lending based on race as is done in the home mortgage arena. Still, another part of the problem is around the performance and capacity of smaller businesses within those communities. Without better information on performance and capacity, financial markets cannot provide credit and capital, and potential business partners cannot in good faith engage those smaller firms. As Federal Reserve Bank Chairman Bernanke has stated, "free markets can be a powerful source of economic development, but markets work less effectively when information about potential opportunities is absent or costly for private actors to obtain."

As a means of reducing the barriers to business and economic development and of reducing the risk related to lack of business information and access to credit in underserved markets, corporations, industries and community organizations can develop mechanisms that can succeed. Progress Through Business has formed a partnership with the International Franchise Association, the Franchise Diversity and Development Initiative (FDDI). We believe that the franchising industry is a prime opportunity for business development and sustainable job creation in minority communities due to the abundance of performance data and reduced risk for franchised businesses. In creating the FDDI, we are developing a mechanism for the sourcing and referral of qualified women and minority prospects, turnkey financing programs, untapped tax credit and incentive programs, location services to develop urban franchises, and technical assistance, training and mentoring for entrepreneurs.

New Markets Tax Credit Program

A number of government programs have been developed to focus investment on these underserved communities, most notably the New Markets Tax Credit program. Many in the financial services community and on Capitol Hill would agree that the program has been very successful. Majority financial institutions have used a substantial proportion of the credits to enhance their own investments in underserved communities. In fact, the President's budget includes a reauthorization of the program for one year at $3.5B. However, I believe the program has a structural flaw in that though it was created as an incentive for business development, it has been used largely as a vehicle for real estate based development. Investors, wary of the rules regarding recapture of the tax credits, are less inclined to invest in entities that are focused on the types of products like working capital, leasehold improvements (and to some extent equipment improvements) that are necessary for the types of businesses within the communities they are meant to target.

Conclusion

Diversity in both the financial services workforce and in the provision of financial services will be to the long-term economic vitality of the industry and this nation. I firmly believe that by working constructively and in partnership, communities and the private sector can implement the programs and procedures now that will lead to greater diversity and greater economic stability in all of our communities leading to long-term economic growth for the nation as a whole.

We thank the Committee for its time and attention to this matter. I will be pleased to answer any questions you may have.